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IN THE

Supreme Court of the United States

OCTOBER TERM, 1949.

No. 601

ATLANTIC COAST LINE RAILROAD COMPANY, *et al.*,
Petitioners,

v.

ST. JOE PAPER COMPANY, *et al.*,
Respondents.

BRIEF OF RESPONDENTS THE LYNCH INTERESTS IN OPPOSITION TO PETITION FOR CERTIORARI.

MILAM, MCILVAINE, CARROLL & WATTLES,
ROBERT R. MILAM,
Greenleaf Building,
Jacksonville, Florida,

OLIVER & DONNALLY,
FRED N. OLIVER,
WILLARD P. SCOTT,
110 East 42nd Street,
New York, N. Y.,

Attorneys for the Lynch Interests.

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Respondents.

BRIEF OF RESPONDENTS THE LYNCH INTERESTS IN OPPOSITION TO PETITION FOR CERTIORARI.

Preliminary Statement.

The Lynch interests, so-called in this proceeding, consist of S. A. Lynch, S. A. Lynch Corporation and certain other bondholders acting together for the protection of their interests, as the owners of Refunding bonds of Florida East Coast Railway Company, the debtor herein.

Both before the Interstate Commerce Commission and the courts below, the Lynch interests have contended that the plan of reorganization approved by a bare majority of the Commission fails to provide fair and equitable treatment for the Refunding bondholders, fails to afford due recognition to their rights and fails to conform to legal standards in certain respects. Their contentions have been sustained by both courts below.

Opinions Below.

The opinions in the Court of Appeals are not yet reported, but are contained in the Record at pages 937 to 956.

The opinion of the District Court is reported at 81 F. Supp. 926.

The reports of the Interstate Commerce Commission are at 252 I. C. C. 423, 252 I. C. C. 731, 254 I. C. C. 865, 261 I. C. C. 151, 267 I. C. C. 295, and 267 I. C. C. 729.

Jurisdiction.

The jurisdiction of this Court is invoked by petitioners under 28 U. S. C. §1254(1). Respondents respectfully submit that the jurisdiction so invoked should be refused in accordance with rule 38 of this Court.

Statement of the Case.

This case is one of the last few Section 77 proceedings remaining in the Federal courts. The debtor railroad has a First Mortgage of $12,000,000, on which interest has been currently paid throughout the proceeding; and a Refunding Mortgage of $45,000,000 on which accumulated interest totals about $35,000,000. It has at all times been generally agreed that no equity remains for the stockholders.

Following institution of the Section 77 proceeding in 1941, the Interstate Commerce Commission held hearings and certified a plan providing a new capital structure aggregating from $35,000,000 to $41,000,000, based on anticipated normal earnings of $1,268,000 annually.

The District Court on October 19, 1943 disapproved the plan and referred it back to the Commission "to afford the Commission an opportunity to re-examine the entire situation in the light of the facts which have developed since the former hearing" (R. 697).

The Commission held further hearings. No new earnings studies were made. Instead, the Commission merely adjusted its estimate of future annual earnings from $1,268,000 to $1,500,000 in recognition of anticipated savings from part of a planned improvement program. On this basis, it provided in its plan of January 8, 1945 for a capital structure, after paying off the First Mortgage, of $40,500,000, with no fixed interest bonds (as contrasted with the potential $41,000,000 in the 1941 plan, of which $14,000,000 to $20,000,000 was in fixed interest bonds).

At the same time the Commission rejected the first offer of Atlantic Coast Line for the property. It pointed out that since the securities proposed to be issued under Atlantic Coast Line's offer, even if taken at par, did not satisfy the claim of the Refunding bondholders, the bondholders must be allowed the entire stock equity, with its accompanying prospects of recoupment (261 I. C. C. at 192).

In the summer of 1945 representations were made to the Commission to the effect, among others, that control by St. Joe Paper Company, a holder of a majority of the Refunding bonds, would not be compatible with the public interest. Atlantic Coast Line made a new proposal for acquisition of the debtor's properties. The Commission reopened the proceedings and in late 1945 took extensive testimony, in Washington and in Florida, principally upon the question of desirability of Atlantic Coast Line control as against St. Joe Paper Company.

This issue arose out of the fact that St. Joe Paper Company, owned by the Alfred I. du Pont Estate, had acquired over a majority of the Refunding bonds. At about the same time members of the so-called Deposit Committee sold substantially all of their holdings (R. 364). The

question was presented as to whether the du Pont Estate had other conflicting interests, whether its trustees were qualified to run a railroad, and whether the du Pont control might not mean operation for the principal benefit of a single private financial interest.

The trial examiner proposed a report which would have affirmed the Commission's 1945 plan, providing again for independent reorganization, despite the Atlantic Coast Line proposals. In April, 1947, the Commission, by a vote of 5 to 4, adopted the present plan, which was substantially the 1945 proposal of Atlantic Coast Line, except that the price it had proposed to pay in cash and securities was raised by the Commission to equal a face amount of $40,500,000, the value fixed for the properties, then and in the 1945 plan (267 I. C. C. 295).

Following reargument, the Commission again split in its position, 6 of the Commissioners favoring adoption of the Atlantic Coast Line plan, while 5 of the Commissioners voted against the plan (267 I. C. C. 729).

At the hearing before the District Court, the creditors were united in their opposition to the plan*, except for the Deposit Committee, which spoke for about 1.3% of the Refunding bonds. The Lynch interests introduced substantial evidence through William A. Gordon, member of Coverdale & Colpitts, bearing upon post-war conditions and prospects (R. 227-288; Lynch Exs. 1-33). This evidence was not controverted. Previously the Commission had declined to reopen its record to receive such evidence of post-war conditions (267 I. C. C. at 729).

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* Since it is generally conceded that the First Mortgage bonds would be paid off under any plan and that the stockholders would get nothing under any plan, the Refunding bondholders are the only security holders substantially affected.

The District Court concluded that the plan proceedings should be referred back to the Commission (R. 466-481). The Court of Appeals affirmed.

Petitioners assert in their petition that if review is granted, they will ask this Court to remand the cause and "direct the entry of an order approving the plan".

Question Presented.

The only question presented is whether, under the facts of this particular reorganization, the District Court acted within the scope of its authority when it disapproved the plan of reorganization put forward by the Interstate Commerce Commission. The Court of Appeals affirmed the District Court and consequently held that the District Court acted within the scope of its authority.

The first seven of the nine questions alleged by petitioners to be presented are in effect different facets of the central question above, although petitioners pose the questions upon the basis of certain assumptions not here valid. The eighth and ninth questions asserted by petitioners, it is submitted, are not here raised.

ARGUMENT.

I.

Disapproval by the District Court of the plan and affirmance of that disapproval by the Court of Appeals raise no questions for review by this Court.

Before the District Court, Atlantic Coast Line took the position that the court was in effect a mere rubber stamp and could only approve the plan of a majority of the Commission (R. 909). Before the Court of Appeals it mod-

ified its position slightly and now, in its petition, it seemingly retracts a little further. But in essence its position is that the District Court had no discretion as to approval.

Petitioners' position overlooks, however, the facts of this case. It disregards, for example, (a) the errors of the Commission, referred to below, (b) the fact that the Commission split almost evenly, a bare majority approving the plan, (c) that the District Court received a large volume of evidence, in accordance with the statutory provisions, that made plain the Commission's disregard of statutory standards, and (d) that the conclusion of the District Court was affirmed by the Court of Appeals.

The petition attempts to find a lack of logic or consistency in the opinions below, while disregarding the pertinent facts to which appropriate legal principles must be applied.

It is the firmly established policy of this Court that in so far as the issues raised by petitioners involve questions of fact upon which the two lower courts concur, they will not be reviewed by this Court. "A seasoned and wise rule of this Court makes concurrent findings of two courts below final here in the absence of very exceptional showing of error." *Comstock* v. *Group of Institutional Investors,* 335 U. S. 211, 214 (1948); *Page* v. *Arkansas Natural Gas Corp.,* 286 U. S. 269, 271 (1932); *Williams Mfg. Co.* v. *United Shoe Machinery Corporation,* 316 U. S. 364, 367 (1942). To similar effect, see *Marcos* v. *Wilson Cyprus Co.* 269 U. S. 82 (1925); *Southern Pacific* v. *Bogert,* 250 U. S. 483 (1919). The District Court here heard the witnesses and examined the exhibits; the Court of Appeals had the benefit of extended examination of the record, voluminous briefs, and oral argument. They have united in condemning the Commission's plan. It is submitted therefore, that in

accord with this established practice, the action in the courts below with respect to matters of fact should not be reviewed.

A. The District Court's Disapproval of the Plan Falls Well Within the Limits of District Court Action Heretofore Fixed by this Court.

The plan adopted by a bare majority of the Commission contained a number of substantial errors and omissions, any one of which, we submit, would have justified disapproval. It suffices to refer to those that can be briefly presented:

1. Price Paid for Bonds Erroneously Relied Upon.

A majority of the Commission concluded that since the value to be received by the Refunding bondholders equaled certain estimates of the prices paid for those bonds (the estimates having been made by counsel for Atlantic Coast Line and not of record) that "the claim of the first and refunding bondholders will under the approved plan be adequately satisfied is obvious" (267 I. C. C. 738). This departure from legal standards was pointed out by the District Court (R. 478).*

Commissioner Mahaffie's dissent emphasized this point (267 I. C. C. at 746):

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* The law is well settled. See, among others: *Cromwell* v. *Sac County*, 96 U. S. 51; *Wade* v. *Chicago S. & St. L. R. Co.*, 149 U. S. 327; *Standard Gas & Electric Co. v. Deep Rock Oil Co.* (C. C. A. 10th), 117 F. 2d 615 (Cert. den. 313 U. S. 564); *Radio-Keith Orpheum Corporation* (C. C. A. 2nd), 106 F. 2d 22 (Cert. den. 308 U. S. 622; rehearing denied 308 U. S. 622); *Security-First Nat. Bank of Los Angeles* v. *Rindge Land & Navigation Co.* (C. C. A. 9th), 85 F. 2d 557, rehearing denied, 86 F. (2d) 3 (Cert. den. 299 U. S. 613; rehearing denied 300 U. S. 686); *Texas Hotel Securities Corp.* v. *Waco Development Co.* (C. C. A. 5th), 87 F. 2d 395 (Cert. den. 300 U. S. 679, rehearing denied 301 U. S. 713, second motion for rehearing denied 81 L. Ed. 1367).

> "This remarkable finding seems to be based on an appendix attached to the summary of the argument of counsel for the Coast Line. It is not of record in this proceeding. And even if the facts stated in it were proven they would not afford a valid basis for the finding above set out."

The Commission's employment of improper legal standards in this instance alone was sufficient to justify disapproval. Even in a case involving doubt as to the standards employed by the Commission, this Court has recently directed a remand to the Commission, *Schwabacher* v. *United States,* 334 U. S. 182 (1948).

2. Refusal to Take into Account Unification Savings.

A majority of the Commission found that savings in expenses that would result from a unification of the debtor with Atlantic Coast Line justified sale of the former's properties to the latter and estimated those savings at "between $350,000 and $1,000,000 per annum" (267 I. C. C. at 325). However, despite the well established practice of crediting each of the properties with one half of such savings (I. C. C. Transcript, p. 2825), and the evidence that most of such savings would be realized within five years, the Commission refused to allow the debtor any credit therefor, totally disregarding this factor in its valuation. If the unification savings are sufficiently significant and definite to call for a forced merger, they are likewise sufficiently significant and definite to require consideration in the valuation process.

This is here borne out by the fact that if the Commission's estimate of unification savings were taken at the median, or $675,000, an equal division between the debtor and Atlantic Coast Line would add $337,000 to the debtor's annual earning power. Capitalizing this amount at 4%

would add $8,400,000 to the value of the debtor and to its sale price.

Under the rule of *Securities and Exchange Commission* v. *Central-Illinois Securities Corp.*, 338 U. S. 96, 128 (1949), this is a "particular question which arose in the valuation process", analogous to the questions in the valuation process therein reviewed by this Court. It is submitted that on this single ground alone, the conclusion of the District Court that the plan could not be approved was fully justified and wholly within the scope of his power.

3. Refusal to Take into Account Improvements in Property.

In its earlier plan rejected by Judge Strum, the Commission found, based upon 1940 conditions, a maximum value of $41,000,000 and a minimum of $35,000,000. Since 1940, the excess of current assets over current liabilities has increased $22,954,000, while cash spent for improvements and bond acquisitions (which would otherwise still be available as cash) has amounted to $17,471,000 or a total of $40,425,000 (Lynch Exs. 1, 28, 29). *Even after allowing $12,000,000 to retire the First Mortgage bonds, this alone almost equals the total cash value approved by the majority of the Commission as the proposed sale price for all of the assets of the debtor.*

The excess of current assets over current liabilities amounts to $25,000,000 (Lynch Ex. 28) of which $8,189,000 would be required to pay the remaining First Mortgage bonds (allowing for $3,811,000 already purchased; Lynch Ex. 29). In contrast, the Commission itself estimated a value of only $30,892,500 for the entire price to be paid by Atlantic Coast Line in securities and cash (267 I. C. C. at 737). It will not do to say that excess cash under the plan will go to the Refunding bondholders, since the Commission

itself pointed out that all but about $1,300,000 (267 I. C. C. at 364) would be impounded for the benefit of Atlantic Coast Line for future improvements, working capital, discharge of prior lien and the like. Thus the Commission either largely ignored net current assets or fixed a value of only about $13,000,000 for the entire roadway, equipment and other remaining tangible assets of the debtor.

On either basis, it is submitted that the Commission clearly erred in the valuation process and failed to follow proper legal standards, within the principle of *Securities and Exchange Commission* v. *Central-Illinois Securities Corp., supra.*

4. Failure to Provide Compensation for Enforced Cash Contributions.

The plan of the Commission majority requires a large cash reserve for completion of a capital improvement program initiated when it was believed that the reorganized company would come into the hands of the Refunding bondholders. However, the plan would require that such enforced cash contribution now be made for the benefit of Atlantic Coast Line, who seeks to acquire. The Refunding bondholders receive no compensation for this enforced cash contribution. Even in adjusting its estimate of earning power, the Commission refused to credit the savings from the improvements, as estimated by the Trustees themselves.* These alone would have increased the normal year estimate of earnings by $603,000, while the Commission increased its estimate by only $232,000. In addition the bondholders are required to make other cash contributions, such as $500,000 *for cash working capital* for the benefit of

* Although the Commission erroneously attributed these estimates to witness Kennedy (261 I. C. C. 161), they were actually made by the Trustees, I. C. C. Transcript 1213-1214.

Atlantic Coast Line, for which no compensation whatever is provided.

This failure of the majority of the Commission to provide "full compensatory treatment" required disapproval by the District Court within the principle established by this Court in *Group of Institutional Investors* v. *Chicago, Milwaukee, St. Paul & Pacific R. Co.* 318 U. S. 523 (1943), and such disapproval was clearly within the power of the District Court.

5. Failure to Provide Compensation for Deprival of Rights to Debtor's Earnings in Prosperous Periods.

The majority of the Commission verbally recognized the necessity of compensation for loss of opportunity of the Refunding bondholders to recoup past losses from future operations of the debtor (267 I. C. C. 307, 374). But it gave mere lip service. This plainly appears from the valuations fixed by the Commission, $41,000,000 in the 1942 plan under which the equity remained in the Refunding bondholders, $40,500,000 in the present plan under which equity is turned over to Atlantic Coast Line.

The Commission referred particularly to the participating feature by which the new preferred stock (given to Refunding bondholders) would participate in all dividends in excess of $4 per share on Atlantic Coast Line common stock. Its reliance on this provision, however, overlooks the fact that Atlantic Coast Line has not paid over $4 dividends on its common stock since 1931, that $4 was paid in only three of those 17 years, during which the simple average was $1.72. Taken together with the provision for call of the preferred stock at par, this renders the participating character of the stock illusory.

It is submitted that reliance by the Commission majority upon such an illusory basis for compensation consti-

tutes mere "lip service" to the rule, contrary to the principle established by this Court in *Group of Institutional Investors* v. *Chicago, Milwaukee, St. Paul & Pacific R. Co.*, 318 U. S. 523 at 570.

6. Failure to Take into Account Changed Conditions Resulting in Increased Earning Capacity of Debtor.

The Commission's estimate of future income of the debtor available for fixed charges after income taxes, based upon evidence of pre-war conditions, was $1,500,000. It refused to reopen the record to receive evidence of permanently changed post-war conditions (267 I. C. C. at 729). In contrast, the uncontroverted evidence before the District Court showed that in the future normal year the debtor could expect net income available for income taxes and fixed charges of $2,850,000 (R. 263-264, Lynch Ex. 27). This estimate was supported and buttressed by detailed showings (Lynch Exs. 6 to 27, inclusive, etc), as well as by comparisons with other southern carriers which indicated the relative superiority of the debtor (Lynch Exs. 2-5).

Since the record before the Commission was closed in 1945, it could not contain any evidence as to post-war conditions. The entire evidence in 1945 was in turn based upon traffic studies of the Trustees introduced at the 1941 hearings and predicated upon pre-war conditions, namely 1940 and earlier depression years.

This is evidenced, for example, by the continued reliance by the Commission upon its original estimate, based upon 1940 conditions, of annual operating income of $12,300,000 (261 I. C. C. at 159). In contrast, the postwar period shows annual operating income for 1946 of $26,543,488, for 1947 of $27,054,334 and 1948 of $28,653,000 (A. C. L. Ex. 17 and 1948 annual report).

The District Court said (R. 479):

> "• • • I am impressed that the evidence produced before me, if it had been before the Commission, might have produced a different result".

In the *Milwaukee* case, this Court said (318 U. S. at p. 542):

> "As we have indicated in the *Western P. R. Corp.* case the power of the District Court to receive additional evidence may aid it in determining whether changed circumstances require that the plan be referred back to the Commission for reconsideration."

Again in *Reconstruction Finance Corporation* v. *Denver & R. G. W. R. Co.*, 328 U. S. 495, 512 (1946) it said:

> "Changes in economic conditions cannot effect the powers of the reorganization agencies even though such changes may require a reexamination into the present fairness of the former exercise of those powers."

Congressional recognition of the necessity for consideration of changed post-war conditions was embodied in the Act of April 9, 1948 (11 U. S. C. A. sec. 208). This Act provides that as to any plan of reorganization under Section 77 approved by the Commission after that date, but not finally confirmed, if the court on petition shall find

> "• • • that changes, facts, or developments have occurred since the approval of such plan by the Commission which were not provided for in the plan and which make it necessary or expedient, in the opinion of the court, that the Commission reexamine and reconsider and revise such plan in order to insure that the plan consummated and put into effect shall then, in the opinion of the court and the Commission, be fair and equitable • • •"

the court shall return the plan to the Commission.

The type of changed conditions specifically referred to in that Act include those as to which evidence was presented to the District Court in this case, such as revenues, expenses, net earnings, improvements to property and cash and net current assets.

Although the provisions of this Act do not technically apply to this case as it stood before the District Court, because of the accident that the Commission's report was rendered March 25, 1948, two weeks before the Act became effective, the principles involved, we submit, should guide the District Court in the exercise of its discretion.

B. This Court Has Upheld the District Court's Power to Review and Reject Plans.

Before a district judge can approve a plan, Section 77(e) requires that he be satisfied, among other things, that the plan

(1) is fair and equitable;

(2) affords due recognition to the rights of each class of creditors and stockholders;

(3) does not discriminate unfairly in favor of any class of creditors or stockholders;

(4) will conform to the requirements of the law of the land regarding the participation of the various classes of creditors and stockholders.

In construing these statutory provisions as to its functions the District Court, as well as the Court of Appeals, followed the standards heretofore laid down by this Court.

In *Ecker* v. *Western Pacific R. R. Co.*, 318 U. S. 448, 473 (1943), this Court said that there is always open to the district court "the question of whether in reaching the result, the Commission has employed improper statutory stand-

ards." Also, "The district court may review to determine whether the Commission has followed the statutory mandates of subsection (e)." *Ibid,* page 477. "Thus, while judicial review does not involve an independent examination into valuation, it does require that the Court shall be satisfied upon the record before the Commission, with such additional evidence as may be pertinent to the Commission's findings of value, that the statutory requirements have been followed." *Ibid,* page 477.

It is evident that this Court intended the district court to examine carefully the Commission's treatment of creditors to determine whether the statutory mandates had been followed. In the *Western Pacific* case this Court, at pages 485-487, carefully examined the allocation of new bonds to the R. F. C. for its $10,000,000 of Trustees' certificates, noted the evidence before the district court that the new bonds were worth less than the old certificates, noted that the district court had made no finding on the point, and held that there was no evidence to indicate that R. F. C. had received more than its just deserts, as the objectors claimed.

This is even more apparent from *Group of Institutional Investors* v. *Chicago, Milwaukee, St. Paul & Pacific R. Co.,* 318 U. S. 523 (1943), where this Court itself, in effect, remanded the plan to the Commission after finding that the treatment accorded the general mortgage bondholders was not the equivalent of the rights surrendered, since it did not include compensation for loss of seniority. The Court said (p. 566):

> "Whether in a given case senior creditors have been made whole or received 'full compensatory treatment' rests in the informed judgment of the Commission and the *District Court* on consideration of all relevant facts. A decision on that issue involves a consideration of the numerous investment features

> of the old and new securities and a financial analysis of many factors." (Emphasis supplied.)

As to whether full compensatory treatment was accorded, "The question in each case is one for the informed discretion of the Commission and the District Court." *Ibid,* p. 564. And again this Court said that "the Commission and the District Court should determine what the General Mortgage bonds should receive" as compensatory treatment. *Ibid,* p. 571.

In *Comstock* v. *Group of Institutional Investors,* 335 U. S. 211 (1948), the Court said (at p. 227):

> "In view of the functions cast upon the court in such cases, we cannot say that it may not, in its discretion, consider objections on their merits even though they have not been presented to the Commission. Some circumstances might be disclosed to indicate a remand for their consideration by the Commission. They might indicate that the courts would withhold approval, not out of deference to the objecting parties' rights but because of the broad responsibility laid upon the court for the equity and fairness of the plan as a whole."

This Court has recognized that a finding as to whether or not a plan of reorganization is fair and equitable involves the exercise of discretion on the part of the district court. As it said in *Group of Institutional Investors* v. *Chicago, Milwaukee, St. Paul and Pacific R. R. Co.,* 318 U. S. 523, 564:

> "Our role on review is a limited one. It is not enough to reverse the District Court that we might have appraised the facts somewhat differently. If there is warrant for the action of the District Court, our task on review is at an end."

Again, in *Comstock* v. *Group of Institutional Investors, supra,* the Court said (335 U. S. at p. 228):

> "The court below evidently considered the circumstances of this case to warrant such inquiry into the merits, and we do not inquire whether the discretion was wisely exercised."

These latter two observations seem particularly pertinent here, where the action of the District Court has received the approval of the Court of Appeals.

Moreover, it is not without significance that the Commission approved the plan by a 6 to 5 vote. It is a reasonable inference that if the finality attributable to certain Commission conclusions arises from its expertness, the fact that the Commission was almost evenly divided would of itself serve to cast considerable doubt upon the conclusions reached in this instance. The proposed report of the trial examiner was apparently in accord with the views of the minority of the Commission.

In the lower courts, both the District Court and a majority of the Court of Appeals have disapproved the plan. Even the dissenting judge in the Court of Appeals seemingly does not go so far as to say the plan should be approved. He criticized the District Court for including certain matters in his opinion, which, however, were not the basis for affirmance. But the dissenting judge's opinion nowhere deals with the errors in the Commission's reports nor does he anywhere say that the plan requires approval.

The dissenting judge did state that the District Court "failed to defer fully to the findings of the Commission." His meaning is not clear. If he intended that the District Court was bound by the Commission's plan, it is submitted that such a conception, while closely approaching that urged by Atlantic Coast Line below, is clearly in conflict with the

decisions of this Court referred to above. In other respects the dissenting opinion is vague as to what disposition should be ultimately made of the plan.

C. The Availability of the Power to Review and Reject Plans is Generally Accepted in the Federal Courts.

The Court of Appeals for the Second Circuit has reversed a district court for erroneously approving a plan where the collateral of certain pledgees had been the subject of erroneous valuations by the Commission, *In re New York, New Haven and Hartford R. R. Co.*, 147 F. (2d) 40 (1945).

Similarly, errors by the Commission, in matters comparable to those here involved, have been held to be sufficient grounds for refusal to approve plans in decisions by district courts rendered subsequent to the decisions of this Court in the *Western Pacific* and *Milwaukee* cases. The Connecticut District Court rejected the Commission's plan for reorganization of the New Haven for a second time in 1943, the grounds of disapproval including, among others, the failure to compensate certain secured creditors adequately, *In re New York, New Haven & Hartford R. R. Co.*, 54 F. Supp. 595. Likewise, the District Court for the Northern District of Illinois, Eastern Division, disapproved a plan of the Commission in 1943 on the ground that senior interests were not adequately compensated, saying that whether or not the Commission had made a specific finding of full compensatory treatment, "it remains for the court to determine whether the Commission was correct on this point", *In re Chicago, Rock Island and Pacific Ry. Co.*, 50 F. Supp. 835.

In addition, errors by the Commission have been grounds for rejection of its plans by district courts in other Section 77 proceedings. Significantly, these decisions have

involved at least six different district courts and no appeal was prosecuted to an appellate court in any one of them.*

D. The Plan of the Commission Majority Violated the Rule of Absolute Priority.

It is submitted that the Commission here violated the principle established in *Northern Pacific Railway Co.* v. *Boyd,* 228 U. S. 484 (1913).

There, a reorganization contract was made between secured creditors and stockholders in which the property was valued and capitalized at $345,000,000, and the stockholders allowed to participate in the new company organized for the purpose of acquiring the assets of the old company. The contract was then consummated by a so-called foreclosure sale at which the property was sold for $61,500,000, which was less than the amount of the senior creditors' claims, thus "freezing out" the unsecured creditors. This Court held that the reorganization was fraudulent and void as to unsecured creditors, because they had been deprived of their rights in the company's property, which was "a trust fund for the payment of creditors", 228 U. S. at p. 504. If there was sufficient value to permit the stockholders to participate, there must *ipso facto* have been sufficient value for the unsecured creditors.

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* See in addition to cases cited above: *In the Matter of Florida East Coast Railway Company,* unreported, D. C. So. Dist. Fla. 1943 set out at R. 690; *In re Louisiana & N. W. R. Co.,* 36 F. Supp. 636 (D. C. S. D. N. Y. 1938); *In re Denver & Rio Grande Western R. R. Co.* (D. C. D. Colo. unreported 1940), and 38 F. Supp. 120 (1941); *In re St. Louis-San Francisco Ry. Co.,* 46 F. Supp. 120 (D. C. E. D. Mo. 1942); *In re New York, New Haven & Hartford R. R. Co.,* unreported (D. C. D. Conn. 1941); *In re Boston & Providence R. Corp.,* 43 F. Supp. 327 (1942); *In re Boston & Providence R. Corp.,* 76 F. Supp. 185 (D. C. D. Mass. 1948); *In re Missouri Pacific Railroad Company,* C. C. A. 8th, unreported (1943).

It is apparent that a majority of the Commission has here proposed to do what was stricken down by this Court in the *Boyd* case. It has proposed a distribution among Florida East Coast security holders of an amount representing the equivalent of the $61,500,000 distribution in the *Boyd* case that this Court held illegal.

As pointed out by the Commission minority, the majority valued the debtor at $40,500,000 but awarded the beneficial owners a payment with an admitted cash value of only approximately $31,000,000 (267 I. C. C. at 737). The difference was to become the profit of Atlantic Coast Line, despite the fact that the Refunding bondholders had a claim of approximately $80,000,000.

In *Insurance Group* v. *Denver and Rio Grande Western R. R. Co.*, 329 U. S. 607, this Court held that the face value of new securities does not determine whether senior creditors have been compensated. Unless the cash value of the new securities equals the face amount of their claim, it there said, the claim has not been satisfied.

The Commission minority pointed out this principle in their dissent (267 I. C. C. at p. 391):

> "Cash and securities as here provided which have a value less than half the face amount of such claims do not meet this test."

The application of the doctrine of absolute priority is not inflexible. As this Court said in the *Milwaukee* case, quoting with approval its language in *Consolidated Rock Products Co.* v. *DuBois*, 312 U. S. 510 (1941), the application of the rule "will be dependent on the facts and requirements of each case". In the same case this Court pointed out the necessity of preventing the property of one interest from being "subtly appropriated to pay the claims

of another *while lip service is rendered* the principles of priority". 318 U. S. at p. 570. (Emphasis added.)

Here, Atlantic Coast Line, as an offeror seeking to buy, having an even more tenuous position in the proceeding than a stockholder, asserts that it should be more favorably treated than stockholders whose equity is gone and who make a fresh cash contribution.

It seeks in effect, by acquisition of the properties at less than the value found by the Commission, to become a distributee of the proceeds of the transaction, by acquisition at a substantial profit, and in fact, to become the principal beneficiary of the plan.

The Commission proposed to divest the Refunding bondholders of their lien for a total claim of approximately $80,000,000 for principal and interest. In return, they would receive a new lien to the extent only of $21,375,000, on the selfsame property only, and the remainder of their lien (whether the property be valued at $40,500,000 or $80,000,000) is handed to the bondholders of Atlantic Coast Line under their after-acquired property clauses. For this lien divested from them, the Refunding bondholders are given only stock of Atlantic Coast Line, inferior to the claims of even unsecured creditors.

This is done, not in a situation involving ordinary adjustments between mortgage divisions of the same system, but in a situation involving an enforced surrender of the properties and of the bondholders' lien thereon to a third-party stranger, under circumstances that clearly violate the rule of absolute priority and result in a taking of property of the Refunding bondholders without due process of law.

II.

The petition fails to set forth sufficient reasons for granting the writ.

As we have already shown, the decision below is not in conflict with applicable decisions of this Court, but is clearly in harmony with them.

Likewise, it is evident that the decision below does not present questions of public importance requiring review by this Court. It merely affirms the conclusion by the District Court that the Commission's errors render the plan unfair and inequitable.

For convenience we will consider the petitioners' alleged reasons for granting the writ in the order set forth by them.

Questions (1) and (2).

Question (1) assumes that statutory standards have been followed, an assumption not warranted in the light of the decision of the two courts below and the facts set forth hereinabove. It further assumes that no question arises as to the doctrine of absolute priority, although this was an issue below, even before the Commission.

Question (2) assumes that, in concluding that the plan was not fair and equitable, the two courts below applied the terms in their colloquial sense, an assumption clearly contrary to fact, as already shown.

However, disregarding the form of the questions, the argument of petitioners, it is submitted, concerns itself with form rather than substance. In dealing with the function of the court, petitioners nowhere deal with the merits of the plan. Their contention that the courts below applied

the test of "colloquial equity" is based wholly upon certain comments in the opinions. These comments, however, have little significance when read in the abstract. When taken in connection with the facts of the case and the actual errors involved, it is evident that both courts below clearly understood their functions under the decisions of this Court.

Question (3).

Judge Hutcheson's comment on the Commission's preoccupation with the struggle for control of the debtor is no conceivable basis for suggesting that he "undertook a type of supervision over the discharge by the Commission of its responsibilities which the Congress did not intend the Courts to exercise" (petition, p. 25).

On the contrary, that comment is a very natural one, expressing a conclusion that is inescapable, both from the record as a whole and from a reading of the Commission's two reports before the Court.* There is no question but that the Commission was faced with a grave problem as to control, but that cannot be an excuse for disregarding the rights of bondholders. This was in fact the very reason for the 6-5 split in the Commission and the earlier 5-4 split. Judge Hutcheson could hardly overlook the fact.

Question (4).

Petitioners here confuse the second and third bases for the District Court's disapproval. The second basis related to disapproval by the bondholders, but it was not the ground

* Of the 113 pages in the two reports, over twice as much space is devoted to the question of control as is devoted to all matters of valuation, fairness of treatment and related questions. The evidence at the reopened hearing, except for that of the Lynch interests, was almost wholly devoted to the question of control.

for affirmance by the Court of Appeals. The latter affirmed on the third basis, namely that the plan is unfair and inequitable, which is the only point raised by petitioners. The Court of Appeals did not place its decision upon the fact of bondholder opposition to the plan. Consequently, further discussion seems unnecessary.

Question (5).

This question relates solely to a mere dictum or observation of the District Court that the proposed merger "ought to be a last resort." It has nothing to do with the decision. We submit that it affords no basis for review by this Court.

Questions (6), (7) and (8).

These questions relate to changed conditions. The facts are these. Judge Strum's order of October 19, 1943 disapproved the Commission's 1942 plan based upon 1940 conditions and referred it back to the Commission "in order to afford the Commission an opportunity to re-examine the entire situation in the light of the facts which have developed since the former hearing" (R. 697). Following the issuance of a new report early in 1945, the Commission held further hearings later in that year, but in its preoccupation with the question of control, gave no effect to changed conditions. It again issued a plan based on 1940 conditions. It subsequently refused to reopen the record, closed in 1945, in order to receive evidence of permanently changed post-war conditions; evidence that was not available at the 1945 hearings. In this respect, we charged in the courts below that the Commission's conduct has been arbitrary and capricious.

Section 3(a)(3) of the act of April 9, 1948, known as the Mahaffie Act and relied upon by petitioners, has no bearing on this point. As appears from the text and as the Congressional history shows, that portion of the Act has no effect on the power of the courts. It was designed to give the Commission power to require a return of the plan where it concluded that conditions required reconsideration. It was evidently included in the Act because members of the Commission had testified before the Senate Committee on Interstate Commerce that if the Commission had such power it would be able to reconsider plans in appropriate cases. It is clear that the power granted to the Commission did not diminish that of the courts and was not intended to do so.*

Question (9).

A review by this Court of all of the objections to the plan before the District Court and of the evidence relating thereto, in order to arrive at a possible conclusion that the District Court and Court of Appeals were wrong in every respect as to the plan, would impose a terrific burden upon this Court and represent a departure from principles heretofore adopted and set forth above. It is submitted that the circumstances of this case do not justify any such consequence.

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* Senate Report No. 897, Committee on Interstate and Foreign Commerce, 80th Cong. 2nd. Sess. to accompany H. R. 2298, at p. 7.

Conclusion.

For the foregoing reasons, we pray that the petition for a writ of certiorari be denied.

Respectfully submitted,

MILAM, MCILVAINE, CARROLL & WATTLES,

ROBERT R. MILAM,

Greenleaf Building,

Jacksonville, Florida.

OLIVER & DONNALLY,

FRED N. OLIVER,

WILLARD P. SCOTT,

110 East 42nd Street,

New York, N. Y

Attorneys for the Lynch Interests.

Dated, March 13, 1950.

Appendix.

Section 77(e) (11 U. S. C. Sec. 205(e)), First Paragraph and First Sentence of Second Paragraph.

(e) Upon the certification of a plan by the Commission to the court, the court shall give due notice to all parties in interest of the time within which such parties may file with the court their objection to such plan, and such parties shall file, within such time as may be fixed in said notice, detailed and specific objections in writing to the plan and their claims for equitable treatment. The judge shall, after notice in such manner as he may determine to the debtor, its trustee or trustees, stockholders, creditors, and the Commission, hear all parties in interest in support of, and in opposition to, such objections to the plan and such claims for equitable treatment.

After such hearing, and without any hearing if no objections are filed, the judge shall approve the plan if satisfied that: (1) It complies with the provisions of subsection (b) of this section, is fair and equitable, affords due recognition to the rights of each class of creditors and stockholders, does not discriminate unfairly in favor of any class of creditors or stockholders, and will conform to the requirements of the law of the land regarding the participation of the various classes of creditors and stockholders; (2) the approximate amounts to be paid by the debtor, or by any corporation or corporations acquiring the debtor's assets, for expenses and fees incident to the reorganization, have been fully disclosed as far as they can be ascertained at the date of such hearing, are reasonable, are within such maximum limits as are fixed by the Commission, and are within such maximum limits to be subject to the approval of the judge; (3) the plan provides for the payment of all costs of administration and all other allowances made or to be made by the judge, except that allowances provided for in subsection (c), paragraph (12) of this section, may be paid in securities provided for in the plan if those entitled

thereto will accept such payment, and the judge is hereby given power to approve the same.

If the judge shall not approve the plan, he shall file an opinion, stating his conclusions and the reason therefor, and he shall enter an order in which he may either dismiss the proceedings or in his discretion and on motion of any party in interest refer the proceedings back to the Commission for further action, in which event he shall transmit to the Commission a copy of any evidence received.

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Supreme Court of the United States

OCTOBER TERM, 1949

No. 601

In the Matter

of

FLORIDA EAST COAST RAILWAY COMPANY,

Debtor.

ATLANTIC COAST LINE RAILROAD COMPANY and the DEPOSIT COMMITTEE for First and Refunding Mortgage 5% Bonds of Florida East Coast Railway Company due 1974,

Petitioners,

v.

ST. JOE PAPER COMPANY, et al.,

Respondents.

BRIEF OF RESPONDENTS PRESIDENT AND DIRECTORS OF THE MANHATTAN COMPANY AND J. BRYSON AIRD, SUCCESSOR TRUSTEES OF THE FIRST AND REFUNDING MORTGAGE BONDS IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

Petitioners, Atlantic Coast Line Railroad Company and the Deposit Committee for First and Refunding Mortgage 5% Bonds of Florida East Coast Railway Company due 1974, have applied to this Court for a writ of certiorari to review the order of the United States Court of Appeals for the Fifth Circuit, dated January 17, 1950, affirming an order of the District Court for the Southern District of Florida, dated January 22, 1949, which disapproved a plan of reorganization of the Florida East Coast Railway

Company, a debtor in a Section 77 proceeding, which had been certified by the Interstate Commerce Commission to the District Court on April 5, 1948.

Opinions Below

The opinions of the Court of Appeals, not yet reported, will be found in the Record at pages 937 to 956.

The opinion of the District Court is reported at 81 F. Supp. 926.

The reports of the Interstate Commerce Commission are reported at 252 I. C. C. 423, 731; 254 I. C. C. 865; 261 I. C. C. 151; 267 I. C. C. 295, 729.

Jurisdiction

Petitioners invoke the jurisdiction of this Court under 28 U. S. C. § 1254(1).

The First and Refunding Mortgage Bondholders and Trustees

The Debtor, Florida East Coast Railway Company, has outstanding $45,000,000 principal amount of First and Refunding Mortgage 5% Bonds, with in excess of $32,000,000 of accrued defaulted interest. Since the First Mortgage is to be paid in full (261 I. C. C. 170; 267 I. C. C. 383), the unsecured creditors are provided for (267 I. C. C. 365-372), and the stockholders do not claim a right to participate, both Commission and Court found that the First and Refunding Bondholders form the only class having an interest in the reorganization and are entitled to the entire equity in the road (261 I. C. C. 173; 267 I. C. C. 304; R. 477). The dissenting Circuit Judge's criticism of this finding is not borne out by the decisions of this Court in *Helvering* v. *Asphaltic Limestone Co.*, 315 U. S. 179, 184, and *Helvering* v. *Cement Investors, Inc.*, 316 U. S. 527, 532.

Of this class, $33,508,500 in amount of bonds are on record in opposition to, and $572,400 in favor of, the present plan.[1]

The Mortgage Trustees, having been appointed in early December, 1948, to succeed Chemical Bank & Trust Company and Howard B. Smith (R. 113-117), intervened in the proceedings before the District Court (R. 124-127), adopted the objections to the plan filed by their predecessors (R. 125), and participated in the appeal.

Petitioners imply that the Trustees are a mere mouthpiece for the majority interests because they were appointed by the St. Joe Company, although obviously no trustee could be appointed without that company's consent; because they refused to rely on statistical studies alone, although the Commission itself had underscored the unreliability of hypothetical market values (267 I. C. C. at 355); and because they testified that "the Trustee is ordinarily persuaded, and should be, by a large majority of its bondholders" (R. 379), although such is the accepted approach for a trustee to take (*Shaw* v. *Railroad Co.,* 100 U. S. 605, 612; *In re Schommer,* 112 F. (2d) 311, 314 (C. A. 7)).

The overwhelming majority in the present case is composed of four substantial bondholder groups, each with diverse interests, but all united in opposition to this plan.

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[1] The record shows the bond holdings to be divided as follows:

Party	*Amount*	
St. Joe Paper Co. and duPont Trust	$25,000,000	(R. 471)
W. G. Welbon, et al.	4,500,000	(R. 297-300)
F. K. Conn, et al.	1,008,500	(R. 106)
S. A. Lynch, et al.	3,000,000	(R. 472)
5% Deposit Committee	572,400	(R. 321)
	$34,080,900	
Remainder not of record	10,919,100	
	$45,000,000	

It is not the purpose of the Trustees to champion any one of these groups, but rather, as the District Judge recognized (R. 472), to speak in behalf of the $10,919,100 in amount of bonds who otherwise have no voice in the proceedings.

There is no problem of reconciling divergent interests as between the bondholders, large or small, because certain errors made by the Commission, of which the District and Circuit Courts were well apprised, deprive the plan of fairness and equity to any bondholder.

The Issues

The District Court's decision rests on three grounds—illegality of a forced merger; opposition of an overwhelming majority of the bondholders; and unfairness and inequity of the plan. In the Court of Appeals, Judge Russell adopted all three grounds, Judge Holmes rejected all three grounds, and Judge Hutcheson affirmed on the third ground. Therefore, while reserving the right to argue the first two grounds in ~~support of~~ opposition to the plan should certiorari be granted, we confine ourselves in this brief to the third ground involving fairness and equity, the only ground before the Court on this petition.

The determination of fairness and equity involves mixed questions of fact and law peculiar to the circumstances of each reorganization. In a series of key decisions this Court has carefully delimited the areas of administrative and judicial action within which these questions of fairness and equity are to be determined in each case.

Ecker v. *Western Pacific R. Co.*, 318 U. S. 448;
Group of Institutional Investors v. *Chicago, Milwaukee, St. Paul & Pacific R. Co.*, 318 U. S. 523;
Reconstruction Finance Corporation v. *Denver & Rio Grande Western R. Co.*, 328 U. S. 495;
Comstock v. *Group of Institutional Investors*, 335 U. S. 211.

Having defined the limits and set the standards generally applicable to all reorganizations, this Court has declined to interfere in the particular reorganization with the legitimate exercise of judgment and discretion within those limits and in accordance with those standards.

> "But we are not performing the functions of the District Court under § 77(e). Our role on review is a limited one. It is not enough to reverse the District Court that we might have appraised the facts somewhat differently. If there is warrant for the action of the District Court, our task on review is at an end" (*Group of Institutional Investors* v. *Chicago, Milwaukee, St. Paul & Pacific R. Co.*, 318 U. S., supra, at 564).

The nine questions raised by petitioners at pages 3 to 5 of their brief simply play variations on one theme—lack of power in, or its improper exercise by the District Court. The questions are posed in terms of language taken from the opinions below, rather than in terms of the single holding now before this Court. That holding is simply that errors in the present plan render it unfair and inequitable as it now stands and require reconsideration by the Commission. Upon such a holding and under the decisions of this Court, the issues are simply—

1. Whether the District Court recognized and respected the limits set on his scope of action;

2. Whether there is warrant for action by the District Court taken within those limits.

Upon the issues as thus restated and condensed, petitioners have failed to show the necessity or usefulness of review under Rule 38(5) of the Rules of this Court.

ARGUMENT

POINT I

The District Judge specifically recognized and correctly stated his limited role in the evolution of a "fair and equitable" plan.

Petitioners would strip the District Judge of any independent affirmative participation in the evolution of a "fair and equitable" plan and would confine him solely to review for errors of law and arbitrary action by the Commission. Judge Sibley, District Judge Designate, as affirmed by Judges Hutcheson and Russell, rightly refused to accept the role of a procedural figurehead for the pro forma approval and confirmation of a plan. Petitioners' contentions disregard reorganization history and the terms of the statute, and misinterpret the opinions of this Court.

1. Reorganization History

Reference herein is made to the equity receivership and reorganization simply to emphasize the critical role of the judiciary in insuring a "fair and equitable" plan prior to legislation on the subject. Section 77 was not enacted in a vacuum and must be read in the light of its background (see *Continental Bank* v. *Rock Island Ry. Co.*, 294 U. S. 648, 672). Accordingly, the "informed, independent judgment" required in equity (*National Surety Co.* v. *Coriell*, 289 U. S. 426, 436) and in Section 77B reorganizations (*Case* v. *Los Angeles Lumber Co.*, 308 U. S. 106, 115) should not be read out of Section 77 except where required by the statutory language as shown below (see *United States* v. *Barnes*, 222 U. S. 513, 520).

2. Section 77

The enactment of Section 77 took out of the hands of bondholders' committees and other private interests the

responsibility for perfecting a plan which protected minority interests and provided a sound capital structure in the public interest, and placed this responsibility in the Commission. But Section 77 did not shift from the Courts the ultimate responsibility that the plan be "fair and equitable" and in fact incorporated in Section 77(e) the very findings which the Courts had come to make in the older equity reorganizations. Under that section, the Judge must be "satisfied" in order to approve a plan that

> "(1) It complies with the provisions of subsection (b) of this section, is fair and equitable, affords due recognition to the rights of each class of creditors and stockholders, does not discriminate unfairly in favor of any class of creditors or stockholders, and will conform to the requirements of the law of the land regarding the participation of the various classes of creditors and stockholders."

These ultimate findings the District Court must affirmatively and independently make upon the record before the Commission and the additional evidence taken before him. The scope of these findings has been limited only in the two fields where the statutory scheme confers power on the Commission alone. The first is the field of public interest. Under Section 77(d) a plan may not be certified to the Court unless it in the opinion of the Commission "will be compatible with the public interest". No such finding is required of the Judge under Section 77(e). The second is the field of valuation. At the end of Section 77(e) it is provided that "if it shall be necessary to determine the value of any property for any purpose under this section, the Commission shall determine such value and certify the same to the Court in its report on the plan". On the other hand, the Court is nowhere directed to redtetermine such value.

While valuations and public interest are for the Commission under the statute, the Court must still review these elements, as it must review any administrative action, for arbitrary or illegal findings.

3. The Cases

The two statutory limitations on the Judge's scope of review have been summed up by this Court in the case of *Reconstruction Finance Corporation* v. *Denver & Rio Grande Western R. Co.*, 328 U. S. 495, as follows:

> "The answer reached by Congress was that the experience and judgment of the Commission must be relied upon for final determinations of value and of matters affecting the public interest, subject to judicial review to assure compliance with constitutional and statutory requirements" (at p. 508).

It has long been held that "the judicial process in bankruptcy proceedings under Section 77 is, as it were, brigaded with the administrative process of the Commission" (*Palmer* v. *Massachusetts,* 308 U. S. 79, 87), but petitioners would limit the scope of review on all phases of reorganization solely to the above narrow review of valuation and public interest. The Courts have never so read the statute. The quotation from the *Denver* case on pages 16 and 17 of petitioners' brief follows directly the above quotation from that case and refers solely to the Court's review of public interest and valuation.

In contrast, the leading case on the co-ordinate functions of Court and Commission, *Ecker* v. *Western Pacific R. Co.,* 318 U. S. 448, confers on the District Court—

> "definite responsibility in reorganization" (at p. 471);

finds that except for public interest and valuations—

> "Upon the other findings of the Commission, the District Court exercised an independent judgment based upon the record and the findings of the Commission together with additional evidence produced before the court by the parties" (at p. 467);

and specifically approves this exercise of the Judge's functions—

> "In this case, we are of the view that the District Court performed its required functions in accordance with the requirements of the statute" (at p. 475).

And, as if this statement of the District Judge's positive functions were not enough, this Court in the case of *Group of Institutional Investors* v. *Chicago, Milwaukee, St. Paul & Pacific R. Co.*, 318 U. S. 523, 568-571, remanded a plan to have the District Court consider, along with the Commission, what a class of bondholders "should receive in addition to a face amount of inferior securities equal to the face amount of their old ones, as equitable compensation, for the loss of their senior rights" (at p. 571). Just such a consideration was made by Judge Sibley in the case at bar (R. 480) and yet is attacked by petitioner as beyond his powers.

Finally, this Court has gone even further in the case of *Comstock* v. *Group of Institutional Investors*, 335 U. S. 211, in holding a District Court authorized to consider objections on their merits not even raised before the Commission, "because of the broad responsibility laid upon the court for the equity and fairness of the plan as a whole" (at p. 227).

The remaining cases cited by petitioners are not in conflict with those discussed above, and if they limit judicial review at all, do so only as to valuations and public interest. Any other interpretation would violate the plain terms of the statute and render meaningless the affirmative findings to be made under Section 77(e). For to give the Judge power to review only for errors of law and lack of supporting evidence is to give him no more than he already has without statutory authority. That is to say, the law has long been that Courts will always review the findings of administrative agencies to determine whether there is error of law or lack of substantial supporting evidence in the record.

Interstate Commerce Commission v. *Union Pacific Railroad Co.*, 222 U. S. 541, 547-548;

Interstate Commerce Commission v. *Louisville and Nashville R. R. Co.*, 227 U. S. 88, 92;
N. L. R. B. v. *Hearst Publications*, 322 U. S. 111, 130-131.*

If this limited review were all that Congress intended, it would have left the matter to the Courts under the above doctrine, or stated the limitation expressly, as in Section 24(a) of the *Public Utility Holding Company Act of 1935* (15 U. S. C. Sec. 79x, 49 Stat. 834):

> "The findings of the Commission as to the facts, if supported by substantial evidence, shall be conclusive."

Review of the "fairness and equity" of a utility simplification under Section 11(e) of the above Act was limited by this specific Congressional directive in the case of *S. E. C.* v. *Central Illinois Securities Corporation*, 338 U. S. 96, cited by petitioners at page 19 of their brief as an authority against the exercise of "colloquial" equity in a railroad reorganization. The difference between the statutory standards of review in the two cases is obvious. In the one, the Court is merely a reviewing agency on the facts. In the other, the Court must make affirmative findings of its own on the question of fairness and equity, a mixed question of fact and law. This Court itself noted in the *Central Illinois* case the danger of citing precedents on judicial review under one statute as precedents for judicial review under another (338 U. S. at p. 122). Further, this Court's analogy in the *Central Illinois* case to review under Section 77 is limited entirely to the proposition that Interstate Commerce Commission findings of *valuation* are final if supported by substantial evidence.

Petitioners throughout refuse to recognize a distinction between subsidiary determinations of fact as to valuations of property and the ultimate finding of equitable compensation based on those valuations. It is one thing

* See also the *Federal Administrative Procedure Act*, Sec. 10(e) (1946) (5 U. S. C. Sec. 1009(e); 60 Stat. 243).

to say that the Judge shall defer to the Commission's essentially business evaluations of the worth of the Florida East Coast Railway. It is another matter altogether to take from the Judge his power and duty of independent review of the question whether the plan based on that valuation affords "fair and equitable" treatment to the bondholders, just because the Commission says it does.

The function of the Commission is to formulate a plan compatible with the public interest. The Judge's function is to insure that private interests are not unduly subordinated in the process. The protection of private rights is a traditional judicial prerogative which the Judge is well qualified by experience to handle.

Under the statutory scheme and the cases construing it, then, we submit that the District Judge correctly stated his functions. In fact the following quotation from his opinion will show how very close his analysis is to that approved in the *Western Pacific case* (318 U. S., supra, at pp. 467, 475):

> "I think the statutory provisions are to be followed as written, Commission and court each acting in the sphere assigned" (R. 472).
>
> "I conclude that the matter of compatability with the public interest of a plan is left to the opinion of the Commission and is not to be reviewed by the judge. Also that certifications of value by the Commission are in general final if the legal standards have been observed. Both are within the peculiar expertness of the Commission. An exception may exist if the judge is investigating a question of Constitutional right which transcends the statute, for such are always judicial rather than administrative questions. And on the matters about which the statute says the judge must be satisfied in order to approve a plan or confirm it over rejection, he has the right to make his independent investigation and is not bound by the conclusions of the Commission thereon. That the judge is not restricted to the facts certified by the Commission but may take additional evidence, is shown by the requirement that if the matter is sent back to the Com-

mission a copy of the additional evidence shall be sent to the Commission. What is fair and equitable and what gives due recognition to the rights of each class of creditors and stockholders, and what is the law of the land, are matters of a judicial nature and within the peculiar expertness of the courts. On them the judge has the last word" (R. 474).

POINT II

The District Judge was amply warranted in returning the plan to the Commission for reconsideration of the treatment to be accorded the Bondholders.

The opposition of the Mortgage Trustees to the present plan is based upon major defects which fully warrant the determination of the District Judge that the treatment accorded the Bondholders was not fair and equitable and ought to be reconsidered by the Commission:

1. The Standard of Valuation

The sale of the Florida East Coast Railway to the Atlantic Coast Line presents other problems in valuation than the mere recapitalization of a single railroad or the simplification of structure in a complex railroad system.

a. The Debtor's Properties

We question whether a capitalization of $40,500,000 made purely on the basis of future earning power in the last plan of internal reorganization (261 I. C. C. 151, 166) affords by itself a fair standard of valuation when adopted in the present merger plan (267 I. C. C. 295, 359) in which the equity in the road is transferred to the Coast Line. The importance of the underlying equity was recognized by the District Judge (R. 477-478), and the differing standards applicable upon the sale of that equity were recognized by the Second Circuit in *Old Colony Bondholders* v. *New York, N. H. & H. R. Co.*, 161 F. (2d) 413, 420 (C. A. 2), cert. den. 331 U. S. 858.

b. The Coast Line Securities to be Given in Exchange

A bondholder is entitled to "a comparison of the new securities allotted to him with the old securities which he exchanges to determine whether the new are the equitable equivalent of the old" (*Group of Institutional Investors* v. *Chicago, Milwaukee, St. Paul & Pacific R. Co.*, 318 U. S. 523, 566). In an internal reorganization, the value of both old and new securities is based on the earning power of the underlying property. If, upon a sale, the value of what the bondholders yield is to be based on future earning power, as has been done in the present case, then the value of what they receive in return, the new Coast Line securities, should also be based on future earning power. *But no estimate of Coast Line earning power has been made* (267 I. C. C. 295, 353-354).

The Commission has apparently valued the new securities simply on the basis of the Coast Line's past operating results (although its margin of profit admittedly rests largely on dividends from Louisville and Nashville stock which the Commission thought should be discounted (267 I. C. C. 295, 352) and upon certain statistical estimates of prospective market values and annual returns found in an appendix to a Coast Line brief (267 I. C. C. 729, 736-737, 740). In order to justify such a cursory comparison of values, the Commission as much as said that whatever the worth of Atlantic Coast Line securities, most of the bondholders were bound to make a profit because of the depreciated price at which they had bought their bonds (267 I. C. C. 729, 736-738). The District Judge ruled out this finding as an improper criterion of equitable equivalence (R. 478) and the correctness of his ruling is long established law. See, e.g., *Wade* v. *Chicago, Springfield, etc., Railroad*, 149 U. S. 327, 343-344; *Standard Gas & Electric Co.* v. *Deep Rock Oil Corp.*, 117 F. (2d) 615, 619 (C. A. 10), cert. den. 313 U. S. 564.

We submit, then, that the bondholders are entitled to reconsideration of the plan, even if no other objection is valid, to have the Commission test and ascertain the value

of the compensation offered by the same standard used to value the property which they are compelled to give up.

2. The Adequacy of Compensation

Assuming that the capitalization of $40,500,000 is a fair sale price, we question whether the allocation to the bondholders of $40,500,000 in face value of cash and inferior securities of the Coast Line affords "full compensatory treatment" (*Otis & Co.* v. *Securities and Exchange Commission,* 323 U. S. 624, 634, ftn. 14) or "the full economic equivalent of what they presently hold" (*Schwabacher* v. *U. S.,* 334 U. S. 182, 199). We fail to see how the Bondholders have received better treatment in this plan than the General Mortgage Bondholders received in the *Milwaukee* plan which was remanded to the Commission by this Court on the ground that:

> "Since junior interests are participating in the plan, the Commission and the District Court should determine what the General Mortgage bonds should receive in addition to a face amount of inferior securities equal to the face amount of their old ones, as equitable compensation, qualitative or quantitative, for the loss of their senior rights" (*Group of Investors* v. *Milwaukee R. Co.,* 318 U. S. 523, 571).

Petitioners argue that no junior interests are involved because they limit the application of the absolute priority rule to the classes of security holders in an internal reorganization, thereby excluding the Atlantic Coast Line. This is a technical argument deserving the technical answer that the Coast Line *is* a junior interest; it is an unsecured creditor. The answer of substance is, however, as made by the Dissenting Commissioners (267 I. C. C. 295, 390-391), that the Coast Line is a stranger to the proceedings who will without justification reap the benefits of any inadequate allocation of new securities to the Bondholders.

a. Quantitative Allocation

Even if $40,500,000 could be called the fair value upon a sale to Coast Line of that which is available for the satisfaction of the Bondholders' claims, the proposed allocation of cash and new securities is admittedly worth much less (267 I. C. C. 729, 737). The difference goes to the Coast Line in violation of the principle behind, if not the literal terms of, the absolute priority rule. This was the opinion of the dissenting Commissioners (267 I. C. C. 295, 390-391; 267 I. C. C. 729, 745-746) and of the District Judge (R. 479-480).

Moreover, the discrimination against senior lienholders in favor of a junior claimant by offering securities equal only in face value to the lienholders' claim is the very defect which led the District Court to disapprove the plan in the case of *In re Chicago, R. I. & P. Ry. Co.*, 50 F. Supp. 835, 856 (D. C., Ill.), and the principle involved is approved by this Court in *Insurance Group Committee* v. *Denver & R. G. W. R. Co.*, 329 U. S. 607, 618, and in *Schwabacher* v. *U. S.*, 334 U. S. 182, 199.

b. Qualitative Allocation

Even if the proposed allocation of cash and securities could be held to give the Bondholders "the equitable equivalent" in quantity of that which is available for the satisfaction of their claim, it fails to recognize and compensate for the quality of the rights which they are forced to surrender. "The important element is the allocation of the securities so as to preserve to creditors the advantages of their respective priorities" (*Ecker* v. *Western R Co.*, 318 U. S. 448, 483).

Giving lip service at least to the right of the Refunding Bondholders to recoup as equity owners of an independent debtor their losses from future earnings, the Commission allocated two shares of redeemable preferred stock to each bond with participation rights as to dividends in excess of $4 per share on Atlantic Coast Line common stock (267

I. C. C. 376, 753). The District Court ruled the preferred stock to be illusory compensation since it could be redeemed if good years ever made the participating provision worthwhile (R. 480).

This ruling on the inadequacy of compensation for loss of equity rights is identical in scope with this Court's ruling on the loss of seniority rights in *Group of Investors* v. *Milwaukee R. Co.*, 318 U. S. 523, 571. (See also *Consolidated Rock Co.* v. *DuBois*, 312 U. S. 510, 529).

3. Changed Conditions

Before the District Court, the Lynch Interests introduced evidence of changed conditions enhancing the earning capacity of the debtor (Lynch Exs. 1-32). This carefully prepared material was presented by a qualified railroad expert (R. 227-230) whose cross-examination by counsel for the Atlantic Coast Line and redirect examination only served to emphasize the abundance of new material which had not been presented to the Commission (R. 275-279, 283, 286, 287).

The District Judge ruled:

> "I am impressed that evidence produced before me, if it had been before the Commission, might have produced a different result" (R. 479).

Such a ruling falls squarely within the authority of the precedents:

> *Group of Investors* v. *Milwaukee R. Co.*, 318 U. S. 518, 542;
> *In re New York, New Haven & Hartford R. Co.*, 147 F. (2d) 40, 46 (C. A. 2), cert. den. 325 U. S. 884;
> *In re Missouri Pac. R. Co.*, 50 F. Supp. 936, 943.

There can be no question of interference with the Commission. The Judge merely determines on the basis of the record before him whether there is enough new material to render reconsideration by the Commission desirable. If

there is evidence in the record to support his determination, this Court has been reluctant to interfere with his informed discretion (*Group of Investors* v. *Milwaukee R. Co.*, 318 U. S. 523, 564).

At page 31 of their brief, petitioners imply from our failure to have recourse to Section 3(a)(3) of the Mahaffie Act a fear of presenting the evidence of changed conditions to the Commission. They forget that our purpose in opposing certiorari is solely to return the plan to the Commission at once for further consideration.

POINT III

Conclusion

Petitioners seek review of that part of the action of a District Judge which has been approved by a Court of Appeals. The District Judge made three rulings, each of which is sufficient by itself to sustain his order. The first two were, for the purpose of a petition for certiorari, eliminated by the Court of Appeals, leaving for consideration by this Court the one ruling on the fairness and equity of the plan.

That ruling the District Judge made only after explicit limitation of his functions (R. 474) within the framework of review approved by this Court (supra, pp. 8-9) and only after careful consideration of the record made before him and the Commission. His determination to return the plan for reconsideration of the treatment accorded the Bondholders finds full precedent in the action of other District Judges reviewing plans.

See, e.g.:

In re Chicago, Rock Island and Pacific Ry. Co., 50 F. Supp. 835, 856 (D. C., Ill.) (failure of proposed new securities to give full compensation for first lien claim);

In re Missouri Pacific Railroad Company, 50 F. Supp. 936, 943 (D. C., Mo.) (changed conditions and failure of Commission to consider compensation for loss of preferred position);

In re Denver & Rio Grande Western R. R., 38 F. Supp. 106, 120 (D. C., Colo.) (insufficient distribution to prior lien bonds, inter alia);

In re Louisiana & N. W. R. Co., 36 F. Supp. 636 (D. C., N. Y.) (failure to provide income bonds as part of new capitalization);

In re Florida East Coast Railway Co. (unreported—D. C., Fla.; see R. 690-697) (unallocated wartime earnings).

The Court of Appeals for the Fifth Circuit, finding warrant in the record below for the District Judge's decision and finding compliance with the statutory standards of Section 77(e), properly refused to interfere with the legitimate exercise of his discretion (R. 945) in determining the fairness and equity of the plan. For similar action in other circuits, see, e.g.:

In re New York, New Haven & Hartford R. Co., 147 F. (2d) 40, 47 (C. A. 2), cert. den. 325 U. S. 884;

In re Denver & R. G. W. R. Co., 150 F. (2d) 28, 36 (C. A. 10), rev. on other grounds 328 U. S. 495;

Chicago, R. I. and P. Ry. Co. v. *Fleming,* 157 F. (2d) 241, 244 (C. A. 7), cert. den. 329 U. S. 780.

The decision of the District Court, as affirmed by the Court of Appeals, does not force petitioner Atlantic Coast Line out of the reorganization nor require petitioner 5% Deposit Committee to sacrifice a single right of its Bondholders. The petition for certiorari reveals no miscarriage of justice, and, since it cannot be said that the District Judge overreached his powers or abused his discretion, presents no suitable question for review by this Court.

Group of Institutional Investors v. *Chicago, Milwaukee, St. Paul & Pacific R. Co.,* 318 U. S. 523, 564.

We pray, therefore, that a writ of certiorari be denied.

Respectfully submitted,

APPLETON, RICE & PERRIN,
63 Wall Street,
New York 5, N. Y.

BEDELL & BEDELL,
315 Guaranty Life Building,
Jacksonville, Florida.

CLIFTON S. THOMSON,
CHESTER BEDELL,
ROBERT M. MCCULLOCH,
GERHARD R. GERHARD,
CHARLES N. SCHENCK, III,
of Counsel.

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